MICHIGAN SOUTH CENTRAL POWER AGENCY

Litchfield, Michigan

FINANCIAL STATEMENTS

June 30, 2004 and 2003

30-7507

Michigan Dept. of Treasury, Local Audit & Finance Division
496 (3-98), Formerly L-3147

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type	Local Government Name	County
☐ City ☐ Township ☐ Village ☒ Other	Michigan South Central Power Agency	Hillsdale
Audit Date June 30, 2004	**Opinion Date** August 12, 2004	**Date Accountant Report Submitted to State:** 8.26.04

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.

☐ yes ☒ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).

☐ yes ☒ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).

☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.

☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).

☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.

☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).

☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).

☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.			X
Reports on individual federal financial assistance programs (program audits).			X
Single Audit Reports (ASLGU).			X

Certified Public Accountant (Firm Name)			
Virchow, Krause + Company, LLP			
Street Address Ten Terrace Court	**City** Madison	**State** WI	**ZIP** 53707
Accountant Signature Russell Mrisson			

MICHIGAN SOUTH CENTRAL POWER AGENCY

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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Michigan South Central Power Agency
Litchfield, Michigan

We have audited the accompanying financial statements as listed in the table of contents, of the Michigan South Central Power Agency as of June 30, 2003 and 2004, and for the years then ended. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Michigan South Central Power Agency as of June 30, 2003 and 2004, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 5 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures that consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Virchow, Krause & Company, LLP

Madison, Wisconsin
August 12, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2004 and 2003

The management of the Michigan South Central Power Agency (MSCPA) offers all persons interested in the financial position of MSCPA this narrative overview and analysis of MSCPA's financial performance during the years ending June 30, 2004 and 2003. Please read this narrative in conjunction with the accompanying financial statements and the accompanying notes to financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Michigan South Central Power Agency is a public body politic and corporate of the State of Michigan. MSCPA was organized on March 21, 1978, under the authority of Michigan Public Act 448 of 1976, to supply electricity to member municipalities in south central Michigan. The Agency has five members: the Cities of Coldwater, Hillsdale, and Marshall; and the Villages of Clinton and Union City.

This annual report consists of two parts: Management's Discussion and Analysis (this section) and the basic financial statements. These statements are prepared on the accrual basis of accounting in accordance with accounting principals generally accepted in the United States of America. The Agency uses the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission.

The Balance Sheet reports year end assets, liabilities and net asset balances based on the original cost adjusted for any depreciation, amortization or unrealized gains/losses as appropriate. The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how MSCPA's net assets changed due to MSCPA's business activity. The Statement of Cash Flows reports the cash provided and used for operating activities, as well as other cash sources such as investment income and cash payments for repayment of bonds and capital additions.

MSCPA FINANCIAL ANALYSIS

An analysis of MSCPA's financial position begins with the review of the Balance Sheet, the Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows report information. A summary of MSCPA's Balance Sheet is presented in Table 1. The Statement of Revenues, Expenses and Changes in Net Assets are summarized in Table 2 and Table 3 presents a summary of the Statement of Cash Flows.

MICHIGAN SOUTH CENTRAL POWER AGENCY

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont.)
June 30, 2004 and 2003

MSCPA FINANCIAL ANALYSIS (cont.)

Table 1
Condensed Balance Sheet

	2004	2003
Utility plant	$ 37,741,846	$ 37,437,708
Restricted assets	18,992,113	17,884,391
Current assets	13,783,360	15,447,893
Other assets	14,592,042	17,936,042
Total Assets	85,109,361	88,706,034
Net assets		
Invested in capital assets, net of related debt	(28,330,635)	(31,545,385)
Restricted	11,256,448	13,607,421
Unrestricted	29,640,299	30,441,137
Total Net Assets	12,566,112	12,503,173
Non-current liabilities	60,704,761	64,929,916
Current liabilities	11,838,488	11,272,945
Total Liabilities	72,543,249	76,202,861
Total Net Assets and Liabilities	$ 85,109,361	$ 88,706,034

Table 2
Condensed Statement of Revenues, Expenses and Changes in Net Assets

	2004	2003
Operating revenues	$ 36,757,645	$ 36,118,189
Depreciation expense	2,991,381	2,888,807
Other operating expenses	25,950,361	25,438,329
Total Operating Expenses	28,941,742	28,327,136
Operating Income	7,815,903	7,791,053
Investment and miscellaneous income	1,581,952	830,926
Interest and amortization expense	(5,044,406)	(5,803,853)
Other income (expense)	(3,681,913)	(3,221,045)
Total Non-Operating Expenses	(7,752,964)	(8,193,972)
Income before contributions and extraordinary item	62,939	(402,919)
Capital contributions and extraordinary item	-	4,972,275
Change in Net Assets	62,939	4,569,356
NET ASSETS – Beginning of Year	12,503,173	7,933,817
NET ASSETS – END OF YEAR	$ 12,566,112	$ 12,503,173

MSCPA FINANCIAL ANALYSIS (cont.)

Table 3
Condensed Statement of Cash Flows

	2004	2003
Received from power sales	$ 32,988,658	$ 34,872,586
Paid to suppliers for purchased power and transmission	(18,600,973)	(18,959,694)
Paid to suppliers and employees for other services	(3,520,288)	(3,320,266)
Cash Flows from Operating Activities	10,867,397	12,592,626
Debt principal and interest paid	(10,590,141)	(10,723,102)
Net debt issuance costs and proceeds	2,198,410	(22,683)
Net acquisition, disposal, and cash contribution for capital assets	(3,378,764)	(612,724)
Cash Flows from Capital and Related Financing Activities	(11,770,495)	(11,358,509)
Cash Flows from Investing Activities	4,282,545	(123,618)
Net Change in Cash and Cash Equivalents	3,379,447	1,110,499
Cash and Cash Equivalents – Beginning of Year	6,613,644	5,503,145
Cash and Cash Equivalents – Ending of Year	$ 9,993,901	$ 6,613,644

BALANCE SHEET

The small change in Utility Plant, approximately $300,000 from June 2003 to June 2004, shows the net effect of fairly large transactions. During the year ended June 30, 2004, MSCPA invested approximately $3,386,000 in capital additions. The major item was the purchase of nine diesel generators, which are able to supply 14.85 MW of peaking power, for $2,220,000. Another large item was the replacement of the Endicott Generating Station step-up transformer, at an approximate cost of $475,000. The "Utility Plant" line reflects these and other, smaller, additions, while also reflecting almost $3 million in normal depreciation.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Fiscal year 2004 is a fairly unremarkable year in terms of stories to tell. Revenues and operating expenses increased less than three percent and two percent, respectively, compared to fiscal year 2003. Interest and miscellaneous income, due in large part to a non-cash "mark to market" entry, was lower than the past year; this lower number was not unexpected. Interest and amortization expense decreased from the prior year. This decrease is due to a full year of lower interest costs from the November, 2002 bond refunding, and also having less amortization charges, again due to the November, 2002 refunding. Reflecting its mission statement to provide value-based electric energy, the Agency strives to charge only what is needed to cover its costs of operations, while fully complying with all debt service covenants. Reporting a net income of $62,939, or a 0.17 percent return on revenues, demonstrates the Agency's commitment to its mission.

MSCPA FINANCIAL ANALYSIS (cont.)

STATEMENT OF CASH FLOWS

"Cash and cash equivalents" are defined as investments which mature in 90 days or less, plus immediately accessible bank accounts. The Agency anticipates spending a large amount of cash on two items in the very near future; the first item is the purchase of an additional 31.5 MW of transmission for $1.881 million, and the other is the construction of a replacement cooling tower for $2.5 million. Although the members will reimburse the Agency for the items over a period of time, the Agency will be responsible for the initial funding. The build-up of cash and cash equivalents as of June 30, 2004, is informally earmarked for these projects.

DEBT SERVICE COVERAGE

MSCPA's bond documents require the Agency to maintain certain restrictive financial covenants, the most restrictive being the requirement that net revenues must equal at least 110% of the aggregate bond service for the year. The Agency fully met or exceeded all bond covenants for the years ended June 30, 2004 and 2003. Further details can be found in Footnote 13.

CONTACTING MSCPA'S MANAGEMENT

This financial report is designed to provide our members, investors, and creditors with a general overview of MSCPA's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Michigan South Central Power Agency, 720 Herring Rd., Litchfield, MI 49252.

Balance Sheets Follow

MICHIGAN SOUTH CENTRAL POWER AGENCY

BALANCE SHEETS
June 30, 2004 and 2003

ASSETS

	2004	2003
NON-CURRENT ASSETS		
CAPITAL ASSETS		
Utility plant (incl. CWIP)	$ 91,437,830	$ 88,477,347
Accumulated depreciation	(53,695,984)	(51,039,639)
Total Utility Plant	37,741,846	37,437,708
OTHER NON-CURRENT ASSETS		
Restricted and unrestricted investments	20,413,718	22,506,447
Debt issue costs	1,722,828	1,996,574
Emissions credits	756,000	-
Deferred maintenance costs	771,719	1,371,719
Deferred costs recoverable in future years	1,213,439	4,812,108
Total Other Non-Current Assets	24,877,704	30,686,848
CURRENT ASSETS		
Cash and cash equivalents	8,237,602	6,613,644
Restricted and unrestricted investments	9,513,682	8,945,661
Accounts receivable	3,314,388	3,168,012
Interest receivable	195,218	224,211
Inventory	824,515	1,215,121
Prepayments and other current assets	404,406	414,829
Total Current Assets	22,489,811	20,581,478
TOTAL ASSETS	$ 85,109,361	$ 88,706,034

NET ASSETS AND LIABILITIES

	2004	2003
NET ASSETS		
Invested in capital assets, net of related debt	$ (28,330,635)	$ (31,545,385)
Restricted for debt service	11,256,448	13,607,421
Unrestricted	29,640,299	30,441,137
Total Net Assets	12,566,112	12,503,173
NON-CURRENT LIABILITIES		
Long-term debt, net of discounts	60,704,761	64,929,916
CURRENT LIABILITIES		
Accounts payable and accrued expenses		
Accounts payable	1,352,210	1,407,946
Compensation and related amounts	496,868	455,730
Deferred rate stabilization	2,253,745	2,277,688
Total Accounts Payable and Accrued Expenses	4,102,823	4,141,364
Current liabilities payable from restricted assets		
Current portion of long-term debt	7,090,548	6,440,000
Accrued interest payable	645,117	691,581
Total Current Liabilities Payable from Restricted Assets	7,735,665	7,131,581
Total Current Liabilities	11,838,488	11,272,945
Total Liabilities	72,543,249	76,202,861
TOTAL NET ASSETS AND LIABILITIES	$ 85,109,361	$ 88,706,034

See accompanying notes to financial statements and independent auditors' report.

MICHIGAN SOUTH CENTRAL POWER AGENCY

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2004 and 2003

	2004	2003
OPERATING REVENUES	$ 36,757,645	$ 36,118,189
OPERATING EXPENSES		
Operations	21,307,923	20,884,316
Maintenance	2,556,723	2,520,510
Administration and general	2,085,715	2,033,503
Depreciation	2,991,381	2,888,807
Total Operating Expenses	28,941,742	28,327,136
Operating Income	7,815,903	7,791,053
NON-OPERATING REVENUE (EXPENSES)		
Investment and miscellaneous income	1,581,952	748,158
Net increase (decrease) in the fair value of investments	(608,597)	82,768
Interest expense on long-term debt	(3,955,960)	(4,516,502)
Gain (loss) on disposal of assets	(83,245)	(24,840)
Amortization of debt costs, discounts, premiums and losses	(1,088,446)	(1,287,351)
Net change in deferred costs excluding capital contributions and extraordinary item	(3,598,668)	(3,196,205)
Total Non-Operating Expenses	(7,752,964)	(8,193,972)
Income Before Contributions and Extraordinary Item	62,939	(402,919)
CAPITAL CONTRIBUTIONS	-	900,540
EXTRAORDINARY ITEM	-	4,071,735
CHANGE IN NET ASSETS	62,939	4,569,356
NET ASSETS - Beginning of Year	12,503,173	7,933,817
NET ASSETS - END OF YEAR	$ 12,566,112	$ 12,503,173

See accompanying notes to financial statements and independent auditors' report.

Statement of Cash Flows Follows

MICHIGAN SOUTH CENTRAL POWER AGENCY

STATEMENT OF CASH FLOWS
Years Ended June 30, 2004 and 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from sales to members	$ 32,988,658	$ 34,872,586
Paid to suppliers for goods and services	(18,600,973)	(18,959,694)
Paid to employees for services	(3,520,288)	(3,320,266)
Net Cash Flows from Operating Activities	10,867,397	12,592,626
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital expenditures for utility plant	(3,385,779)	(970,564)
Capital contributions		350,540
Proceeds from sale of utility plant	7,015	7,300
Debt issuance costs	(21,590)	(1,034,574)
Proceeds from issuance of new debt	2,220,000	1,011,891
Principal payments on long-term debt	(6,587,717)	(6,110,000)
Interest payments on long-term debt	(4,002,424)	(4,613,102)
Cash Flows From Capital and Related Financing Activities	(11,770,495)	(11,358,509)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	22,635,848	8,472,323
Purchases of investments	(19,355,651)	(9,459,616)
Interest received	1,002,348	863,675
Cash Flows from Investing Activities	4,282,545	(123,618)
Net Change in Cash and Cash Equivalents	3,379,447	1,110,499
CASH AND CASH EQUIVALENTS – Beginning of Year	6,613,644	5,503,145
CASH AND CASH EQUIVALENTS – END OF YEAR	$ 9,993,091	$ 6,613,644
NON CASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Contributions	$ -	$ 550,000
Debt Refunded	$ -	$ 33,300,000

	2004	2003
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES		
Operating income	$ 7,815,903	$ 7,791,053
Noncash Items Included in Operating Income		
Depreciation	2,991,381	2,888,807
Deferred maintenance	600,000	600,000
Changes in assets and liabilities		
Accounts receivable	(146,376)	1,174,200
Inventory	390,606	(159,439)
Emissions credits	(756,000)	
Prepayments	10,423	72,089
Accounts payable	(55,736)	(556,062)
Arbitrage rebate payable		(34,651)
Compensation and related amounts	41,139	84,476
Deferred rate stabilization	(23,943)	732,153
NET CASH FLOWS FROM OPERATING ACTIVITIES	$ 10,867,397	$ 12,592,626
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE BALANCE SHEET		
Current investments	$ 9,513,682	$ 8,945,661
Non current investments	20,413,718	22,506,447
Cash and cash equivalents	8,237,602	6,613,644
Total Cash and Investments	38,165,002	38,065,752
Less: Long-Term Investments	(28,171,911)	(31,452,108)
TOTAL CASH AND CASH EQUIVALENTS	$ 9,993,091	$ 6,613,644

See accompanying notes to financial statements and independent auditors' report.

NOTE 1 – NATURE OF OPERATIONS

The Michigan South Central Power Agency (the Agency) is a body politic and corporate, of the State of Michigan organized on March 21, 1978, under the authority of Michigan Public Act 448 of 1976 (the Act), to supply electricity to member municipalities in south central Michigan. The Act provides that the Agency will establish rates and charges so as to produce revenues sufficient to cover costs (excluding depreciation and amortization expense) including debt service, but it may not operate its projects for profit, except insofar as any such profit will inure to the benefit of the public.

The Agency's member municipalities are the Cities of Coldwater, Hillsdale and Marshall and the Village of Clinton and Union City. Each is a municipal corporation, organized under the laws of the State of Michigan, which owns and operates a municipal electric system. The member municipalities presently supply their customers with power and energy generated from the Agency's Project I and from the municipalities' existing generating facilities and also with power purchased from other utility companies. Project I consists of a 55 MW coal fired generation facility and related transmission and substation equipment. Project II consists of a series of diesel fired peaking units capable of producing 16.5 megawatts of power. Project III consists of a series of diesel fired peaking units capable of producing 14.85 megawatts of power. The Agency is currently evaluating the feasibility of relocating units to Project I and member municipality sites. This relocation would provide for increased local generation under blackout conditions. The participants of Project I and Project III are the Cities of Coldwater, Hillsdale and Marshall, the Villages of Clinton and Union City. All members except the Village of Union City are participants in Project II.

Each of the member municipalities entered into (a) a Power Sales Contract with the Agency for the supply of power and energy from the Agency and (b) a Substation Agreement with the Agency for services provided by the Agency to the member municipality with respect to substation facilities; both of these agreements will remain in effect as long as Power Supply System Revenue Refunding Bonds (Revenue Refunding Bonds), 2002, 1994, and 1992 Series and Power Supply System Revenue Bonds Series 2003 are outstanding. Each member municipality also entered into an Economic Dispatch Agreement with the Agency providing for the dispatch by the Agency of power and energy from certain existing generating facilities of the member municipalities on an economic basis. The Power Sales Contract between the Agency and the member municipalities require the Agency to provide, and the member municipalities to purchase from the Agency, all of the members' bulk power supply, as defined in the contracts. Each member is obligated to pay its share of the Agency's operating and debt service costs of Project I. The Substation Agreements require the Agency to provide, and the municipalities to purchase, services of the municipalities' substation facilities for transmission, transformation and delivery of electric power and energy from the Agency to the municipalities. Under the Economic Dispatch Agreement, the member municipalities are required to sell to the Agency power generated by their facilities, defined s dedicated capacity.

During the years ended June 30, 2004 and 2003, substantially all sales of power recognized by the Agency were made to its member municipalities.

NOTE 1 – NATURE OF OPERATIONS (cont.)

BASIS OF PRESENTATION

In accordance with Governmental Accounting Standards Board (GASB) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund accounting,* the Agency applies all applicable GASB pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principals Board (APB) Opinions, and Accounting Research Bulletins (ARB), unless those pronouncements conflict with or contradict GASB pronouncements.

The Agency's accounts are maintained in accordance with the Uniform System of Accounts of the Federal Energy Regulatory Commission, as required by the Power Sales Contracts with the member municipalities, and in conformity with accounting principles generally accepted in the United States of America. A separate set of plant accounts is maintained for each of the Agency's projects.

On July 1, 2002, MSCPA adopted the provisions of Governmental Accounting Standards Board Statement No. 34 *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* Statement No. 34 established standards for external financial reporting for all state and local governmental entities which includes a balance sheet, a statement of revenues, expenses, and changes in net assets and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in capital assets, net of related debt* – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- *Restricted* – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

- *Unrestricted* – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

NOTE 1 – NATURE OF OPERATIONS (cont.)

USE OF ESTIMATES

Preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

CAPITAL ASSETS – UTILITY PLANT

The cost of utility plant includes direct and overhead costs. Interest incurred during construction is reflected in the capitalized value of assets, net of interest earned on the invested proceeds over the same period.

When property subject to depreciation is retired or otherwise disposed of in the normal course of business, its cost, together with the cost of removal less salvage, is charged to accumulated depreciation.

The cost of maintenance, repairs and replacements of minor items of property is charged to maintenance expense. The cost of replacements of property is charged to utility plant accounts.

Utility plant in service is depreciated using the straight-line method over the following useful lives:

	Years
Utility Plant in Service	
Project I (composite) – Endicott Generation Station	30
Project II (composite) – Diesel Fired Peaking Unit	30
Project III (composite) – Diesel Fired Peaking Units	30
Substation plant (composite)	30
Transmission facilities (composite)	55
Administrative and maintenance building	10 – 50
Transportation equipment	3 – 5
Furniture and fixtures	5 – 10

CASH EQUIVALENTS

For purposes of the statement of cash flows, cash equivalents include unrestricted checking accounts, savings accounts and institutional liquid assets, with initial maturities less than 90 days.

RESTRICTED AND UNRESTRICTED INVESTMENTS

The Agency follows GASB No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* This standard requires investments to be reported at fair value with gains and losses included in the Statement of Revenues, Expenses and Changes in Net Assets.

NOTE 1 – NATURE OF OPERATIONS (cont.)

INVENTORY

Inventory is stated at average carrying cost and consists of coal, limestone and fuel oil.

DEBT RELATED ITEMS

Bond issuance costs, premiums and discounts are deferred and amortized over the life of the bonds based on the effective interest method, with the exception of the 2002 and 2003 bond costs which are amortized on a straight line basis. Losses on refundings are amortized on the straight line method effective in fiscal 2003.

DEFERRED COSTS AND CREDITS

The Agency has adopted the provisions of Statement of Financial Accounting Standards (FAS) No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS No. 71). This accounting standard provides for the deferral of costs and revenues which will be recovered through future rate adjustments.

OPERATING REVENUES

The Agency distinguishes *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering electric service in connection with the Agency's principal ongoing operations. The principal operating revenues of the Agency are charges to members for sales and services. Operating expenses for the Agency include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Agency billings are rendered and recorded monthly based on month end metered usage.

CONTRIBUTED CAPITAL

On January 1, 2001, the Agency adopted the provisions of Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.* This statement requires that capital contributions from external parties be presented as revenues beginning in 2001.

NOTE 1 – NATURE OF OPERATIONS (cont.)

INTEREST INCOME CREDIT

If approved by the Agency's rate-making body, the Agency may grant to its members a credit for interest income earned from the pool of temporary investments held by the Agency (see Note 6). There were no interest income credits granted to the Agency's members for the years ended June 30, 2004 and 2003.

TAXES

The Agency is exempt from State and Federal income taxes.

COMPENSATED ABSENCES

Under terms of employment, non-union employees are granted twelve sick and personal days per year on January 1st. This time cannot be carried over from year to year and is not paid out at year end. Vacation time does accrue for non-union employees, but cannot be carried over. Sick leave and vacation benefits earned but not yet taken have been recorded in the financial statements. Union employees are granted two personal days per year which cannot be carried over from year to year.

NOTE 2 – CASH AND INVESTMENTS

The Agency's Trust Indenture for the Power Supply System Revenue Refunding Bonds (Note 5) authorizes the Agency to deposit funds only in banks insured by the Federal Deposit Insurance Corporation. The Agency may also make investments in U.S. Government and federal Agency obligations, investment grade bonds, commercial paper rated at the highest classification established by at least two standard rating services, money market mutual funds, repurchase agreements, and pooled investment funds. The Agency's internal policy is to not invest funds in repurchase agreements.

The Agency's deposits and investments are categorized to give an indication of the level of risk assumed by the entity at year end. Category 1 includes items that are insured or registered or which are collateralized by or evidenced by securities held by the Agency or its agent in the Agency's name. Category 2 includes deposits collateralized with securities held by the pledging institution's trust department or agent in the Agency's name, or uninsured and unregistered investments for which the securities are held by the counter party's trust department or agent in Agency's name. Category 3 includes uncollateralized deposits, and uninsured and uncollateralized investments.

Investments in government money market funds are not able to be categorized because they are not evidenced by securities that exist in physical or book entry form.

MICHIGAN SOUTH CENTRAL POWER AGENCY

NOTES TO FINANCIAL STATEMENTS
June 30, 2004 and 2003

NOTE 2 – CASH AND INVESTMENTS (cont.)

CASH AND INVESTMENTS – JUNE 30, 2004

	Category 1	Category 2	Category 3	Bank Balance	Carrying Value
Certificates of Deposits and Bank Deposits	$ 255,330	$ -	$ 285,579	$ 540,909	$ 479,530
U.S. Treasury Notes	5,505,706	-	-	5,505,706	5,505,706
U.S. Government Agencies	22,898,256	-	-	22,898,256	22,898,256
Totals	$ 28,659,292	$ -	$ 285,579	28,944,871	28,883,492
Investments not subject to categorization:					
Government Money Market Funds				9,281,110	9,281,110
Cash on hand				-	400
Total Cash and Investments				$ 38,225,981	$ 38,165,002

CASH AND INVESTMENTS – JUNE 30, 2003

	Category 1	Category 2	Category 3	Bank Balance	Carrying Value
Certificates of Deposits and Bank Deposits	$ 286,775	$ -	$ 17,478	$ 304,253	$ 135,093
U.S. Treasury Notes	1,169,954	-	-	1,169,954	1,169,954
U.S. Government Agencies	20,093,227	-	-	20,093,227	20,093,227
Totals	$ 21,549,956	$ -	$ 17,478	21,567,434	21,398,274
Investments not subject to categorization:					
Government Money Market Funds				16,666,795	16,667,078
Cash on hand				-	400
Total Cash and Investments				$ 38,234,229	$ 38,065,752

NOTE 2 – CASH AND INVESTMENTS (cont.)

Investments are stated at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties. Fair values are based on quoted market prices. No investments are reported at amortized cost. Adjustments necessary to record investments at fair value are recorded in the operating statement as increases or decreases in investment income.

Deposits in banks are insured by the FDIC in the amount of $100,000 for all interest bearing accounts and $100,000 for all noninterest bearing accounts. The difference between the bank balance and carrying amount is due to outstanding checks, deposits in transit, and/or market value adjustments.

NOTE 3 – RESTRICTED AND UNRESTRICTED INVESTMENTS

The Power Supply System Revenue Bond Resolution requires that the payments by the member municipalities for project power be deposited into special funds and that they be used only for operating costs, debt service and other stipulated purposes. The fund's purposes and balances are summarized below.

Fund	Purpose
Operations and Maintenance	To accumulate sufficient funds by the end of each month to pay the subsequent month's expenses.
Bond Service Fund	To accumulate funds to pay the current portion of the bond principal and interest.
Bond Reserve Fund	To reserve funds equal to the maximum annual principal and interest requirements for the outstanding bonds.
Reserve and Contingency Fund	To reserve funds for major renewals and replacements, extraordinary operations and maintenance costs, and any contingencies.
2000 Project Fund	Unspent debt proceeds to be used for the construction of capital assets referred to as Project II.
2002 Project Fund	Unspent debt proceeds to be used for the repayment of the 2002 Revenue Refunding Bonds.

NOTE 3 – RESTRICTED AND UNRESTRICTED INVESTMENTS (cont.)

The following is a summary of investments as of June 30, 2004 and 2003.

	2004	2003
Current Investments		
Restricted		
Bond service fund	$ 5,815,216	$ 5,158,753
Bond reserve fund	2,612,068	2,224,940
Reserve and contingency fund	279,166	214,254
2000 project fund	-	380,087
2002 project fund	-	10,162
Unrestricted	807,232	957,465
Total Current Investments	9,513,682	8,945,661
Non-Current Investments		
Restricted		
Bond reserve fund	9,510,371	9,065,879
Reserve and contingency fund	775,292	830,316
Unrestricted	10,128,055	12,610,252
Total Non-Current Investments	20,413,718	22,506,447
Total Investments	29,927,400	31,452,108
Cash and cash equivalents – unrestricted	8,237,602	6,613,644
Total Cash and Investments	$ 38,165,002	$ 38,065,752

NOTE 4 – CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets for 2004 and 2003 follows:

2004	Balance 6/30/03	Additions/ Reclassi-fications	Deletions/ Reclassi-fications	Balance 6/30/04
Capital assets being depreciated:				
Project I (composite) – Endicott Generation Station	$ 76,634,847	$ 937,674	$ (291,804)	$ 77,280,717
Project II (composite) – Diesel Fired Peaking Unit	5,920,981	-	-	5,920,981
Project III	-	2,200,000	-	2,200,000
Land[1]	1,278,823	-	-	1,278,823
General plant	4,623,170	184,580	(133,477)	4,674,273
Construction work in progress[1]	19,526	1,146,120	(1,082,610)	83,036
Less: Accumulated depreciation	(51,039,639)	(2,991,381)	335,036	(53,695,984)
Net Utility Plant	$ 37,437,708	$ 1,476,993	$ (1,172,855)	$ 37,741,846

[1] – Capital assets that are not being depreciated.

NOTE 4 – CHANGES IN CAPITAL ASSETS (cont.)

2003	Balance 6/30/02	Additions/ Reclassi-fications	Deletions/ Reclassi-fications	Balance 6/30/03
Capital assets being depreciated:				
Project I (composite) – Endicott Generation Station	$ 74,448,308	$ 2,282,009	$ (95,470)	$ 76,634,847
Project II (composite) – Diesel Fired Peaking Unit	5,920,149	832	-	5,920,981
Land[1]	1,278,823	-	-	1,278,823
General plant	4,610,867	12,303	-	4,623,170
Construction work in progress[1]	1,344,106	56,452	(1,381,032)	19,526
Less: Accumulated depreciation	(48,214,162)	(2,888,807)	63,330	(51,039,639)
Net Utility Plant	$ 39,388,091	$ (537,211)	$ (1,413,172)	$ 37,437,708

[1] – Capital assets that are not being depreciated.

NOTE 5 – LONG TERM DEBT

The Agency has issued the following revenue bonds:

Date	Purpose	Final Maturity	Interest Rates	Original Issue
Nov. 1, 1992	Partial refunding of 1986 revenue refunding bonds	Nov. 1, 2006	3.50–5.90%	$ 52,425,000

The annual debt service requirements of the 1992 bonds to maturity are as follows:

Year	Principal	Interest	Total
2004	$ 6,805,000	$ 1,253,895	$ 8,058,895
2005	7,190,000	866,010	8,056,010
2006	7,610,000	448,990	8,058,990
Totals	$ 21,605,000	$ 2,568,895	$ 24,173,895

NOTE 5 – LONG TERM DEBT (cont.)

Date	Purpose	Final Maturity	Interest Rate	Original Issue
Dec. 1, 1994	Partial refunding of 1986 revenue refunding bonds	Nov. 1, 2011	7.00%	$ 8,385,000

The annual bond service requirements of the 1994 bonds to maturity are as follows:

Year	Principal	Interest	Total
2004	$ -	$ 586,950	$ 586,950
2005	-	586,950	586,950
2006	-	586,950	586,950
2007	-	586,950	586,950
2008	-	586,950	586,950
2009	-	586,950	586,950
2010	-	586,950	586,950
2011	8,385,000	586,950	8,971,950
Totals	$ 8,385,000	$ 4,695,600	$ 13,080,600

Date	Purpose	Final Maturity	Interest Rate	Original Issue
Dec 20, 2000	Project II	May 1, 2012	6.00%	$ 6,475,000

The annual bond service requirements of the 2000 bonds to maturity are as follows:

Year	Principal	Interest	Total
2004	$ -	$ 388,500	$ 388,500
2005	-	388,500	388,500
2006	-	388,500	388,500
2007	-	388,500	388,500
2008	-	388,500	388,500
2009	-	388,500	388,500
2010	990,000	388,500	1,378,500
2011	1,570,000	329,100	1,899,100
2012	3,915,000	234,900	4,149,900
Totals	$ 6,475,000	$ 3,283,500	$ 9,758,500

NOTE 5 – LONG TERM DEBT (cont.)

Date	Purpose	Final Maturity	Interest Rate	Original Issue
Nov 21, 2002	Refunding of 1991 and 1986 revenue refunding bonds	Nov 1, 2011	5.00%	$ 31,190,000

The annual bond service requirements of the 2002 bonds to maturity are as follows:

Year	Principal	Interest	Total
2004	$ -	$ 1,559,500	$ 1,559,500
2005	-	1,559,500	1,559,500
2006	-	1,559,500	1,559,500
2007	-	1,559,500	1,559,500
2008	7,535,000	1,371,125	8,906,125
2009	7,895,000	985,375	8,880,375
2010	8,290,000	580,750	8,870,750
2011	7,470,000	186,750	7,656,750
Totals	$ 31,190,000	$ 9,362,000	$ 40,552,000

Date	Purpose	Final Maturity	Interest Rate	Original Issue
Sept 3, 2003	Project III	Nov 1, 2010	4.08%	$ 2,220,000

The annual bond service requirements of the 2003 bonds to maturity are as follows:

Year	Principal	Interest	Total
2004	$ 141,378	$ 40,927	$ 182,305
2005	291,188	73,423	364,611
2006	302,803	61,808	364,611
2007	314,881	49,729	364,610
2008	327,442	37,168	364,610
2009	340,504	24,107	364,611
2010	354,087	10,524	364,611
Totals	$ 2,072,283	$ 297,686	$ 2,369,969

NOTE 5 – LONG TERM DEBT (cont.)

Long-term debt activity for the year ended June 30, 2004 and 2003, is as follows:

	6/30/03 Balance	Additions	Reductions	6/30/04 Balance	Due Within One Year
Revenue bonds	$ 74,095,000	$ 2,220,000	$ (6,587,717)	$ 69,727,283	$ 7,090,548
Discounts/Premiums	1,565,624		(202,054)	1,363,570	
Loss on refunding*	(4,290,708)		995,164	(3,295,544)	
Net Bonds	$ 71,369,916			$ 67,795,309	

	6/30/02 Balance	Additions	Reductions	6/30/03 Balance	Due Within One Year
Revenue bonds	$ 82,315,000	$ 31,190,000	$ 39,410,000	$ 74,095,000	$ 6,440,000
Discounts/Premiums	(1,510,509)	3,121,891	(45,758)	1,565,624	
Loss on refunding*	-	(5,364,772)	(1,074,064)	(4,290,708)	
Net Bonds	$ 80,804,491			$ 71,369,916	

*Historically these were included in deferred costs. In fiscal 2003 they were reassessed as unrecoverable and the unamortized portion established as a contra liability (see Note 12).

NOTE 6 – NET DEFERRED COSTS RECOVERABLE IN FUTURE YEARS

Deferred costs/credits recoverable in future years consist of costs incurred by the Agency which were not billed to the member municipalities during the period in which they were incurred and interest and miscellaneous income not yet credited to the member municipalities. These amounts have been composed of six major types of expenditures/credits: (1) depreciation and amortization expense (noncash expenditures which under the Power Sales Contracts cannot be billed to the member municipalities) in excess of the principal repayments on related debt, (2) interest and miscellaneous income not yet credited to the member municipalities, (3) losses from investment securities transactions not yet charged to the member municipalities, (4) startup costs prior to April 1983 not billed to the member municipalities but paid by the Agency from bond proceeds, (5) the losses on refinancings of 1986, 1991, and 1992 Series Bonds to be recovered from future billings to participants through the payments of debt service on the 2002, 1994, and 1992 Series Bonds, and (6) arbitrage rebate expense.

NOTE 6 – NET DEFERRED COSTS RECOVERABLE IN FUTURE YEARS (cont.)

GAAP requires that these items be removed from the statement of net revenues and expenses and accumulated equity, and recorded as an asset or liability in the year in which they were incurred. These items are then recognized in future years when the item is included in allowable costs for rate-making purposes. During fiscal 2003, management reassessed the expenditures/credits were for future recoverability. Any items that will not be recovered through future member billing have removed and reported as an extraordinary item (see Note 12) in fiscal 2003. The losses on refundings are to be amortized over the life of the bonds. Remaining unamortized amounts have been recorded as a contra liability.

Principal payments are expected to exceed depreciation and amortization through 2011, at which time such deferred costs should be fully amortized. The other components, excluding interest income, are not expected to have a substantial effect on the amounts capitalized as deferred costs.

The components of the deferred costs recoverable in future years as of June 30, 2004 and 2003 are as follows:

	2004	2003
Deferred costs recoverable in future periods:		
Depreciation and amortization in excess of principal payments	$ 1,213,439	$ 4,812,108
Total Deferred Costs Recoverable in Future Periods	$ 1,213,439	$ 4,812,108

The change in the components of deferred costs recoverable in future years for the years ended June 30, 2004 and 2003, are as follows:

	2004	2003
Depreciation and amortization less than debt service principal payments	$ (3,598,668)	$ (3,196,205)
Decrease in Deferred Costs Per Income Statement	(3,598,668)	(3,196,205)
Interest credited to members as capital contribution	-	443,726
Unamortized refunding losses	-	(4,290,708)
Current year amortization for refunding losses	-	(995,164)
Write off of unrecoverable items (see Note 12)	-	4,071,735
Net Decrease in Deferred Costs	-	(3,966,616)
Deferred costs recoverable in future periods	4,812,108	25,732,215
Deferred credits	-	(16,953,491)
Balance at Beginning of Year	4,812,108	8,778,724
Deferred costs recoverable in future periods	1,213,439	4,812,108
Balance at End of Year	$ 1,213,439	$ 4,812,108

NOTE 6 – NET DEFERRED COSTS RECOVERABLE IN FUTURE YEARS (cont.)

Additionally, in 2001, the Agency's Board approved the deferral of approximately $3,200,000 in maintenance costs incurred for the overhaul of the turbine generator. Such costs will be recognized as a component of maintenance expense, at a rate of approximately $600,000 per year through 2005.

NOTE 7 –DEFERRED RATE STABILIZATION

Effective in September 1994, management of the Agency implemented a plan to provide its members with refunds utilizing in assets of a rate stabilization equity fund then held by the Agency.

Effective in August 1996, management of Agency implemented a new plan to provide a rate relief in future periods to the Agency's members utilizing advance contributions of the members.

Amounts previously included in equity were reclassified in 2003; see Note 13.

The equity fund, which then totaled approximately $3,000,000 consisted of member contributions aggregating approximately $1,200,000 and interest thereon totaling approximately $1,800,000, and was originally established in 1986 to provide rate relief in future periods to the Agency's members. The Agency anticipates that the remaining undistributed member contributions of $1,000,000 and undistributed interest earned on the equity fund of $1,200,000 will be distributed to its members in an indeterminable period in the future out of currently available unrestricted accumulated equity.

As of June 30, 2004 and 2003, the Agency had received cumulative contributions totaling $7,123,521 and $7,089,282, respectively, and provided cumulative distributions to its members totaling $5,313,503 and $5,255,320, respectively. Interest accrued on these funds of $2,678,683 and $2,564,627, respectively, is included in the fund equity.

The Agency anticipates the member contributions will be distributed to its members in an indeterminable period in the future out of currently available unrestricted funds. Accordingly, at June 30, 2004 and 2003, the Agency has established a liability of $2,253,745 and $2,277,688, respectively, for Deferred Rate Stabilization.

NOTE 8 – EMPLOYEE RETIREMENT PLAN

The Agency contributes to the Municipal Employees Retirement System of Michigan (MERS), an agent defined benefit multiple-employer public employee retirement system that acts as a common investment and administrative agent for municipalities. The Agency's defined benefit pension plan provides retirement and disability benefits to covered employees and beneficiaries. The present benefit provisions of MERS are governed by Act No. 220 of the Public Acts of 1996, as amended and the MERS Plan Document as revised. The MERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Municipal Employees Retirement System of Michigan, 447 N. Canal Road, Lansing, Michigan 48917.

The Agency funds the entire cost of each employee's participation in MERS. Contribution requirements of employees and the Agency are established and may be amended by the MERS Board of Trustees.

For 2004, 2003 and 2002 the Agency's annual pension cost of $256,572, $235,623, and $202,565, respectively, for the MERS was equal to the Agency's required and actual contributions. There was no net pension obligation as of June 30, 2004, 2003 or 2002.

The 2004 required contribution was determined as part of the December 31, 2000 actuarial valuation using the entry age normal cost method. This method seeks to provide a level pattern of cost as a percentage of salary throughout an employee's working lifetime. The actuarial assumptions included: (a) 8.0% investment rate of return in 2004, 2003 and 2002, (b) projected salary increases of 4.5% in 2004, 2003 and 2002, and (c) additional projected salary increases ranging from 0% to 4.16% in 2004, 2003 and 2002 depending on age, attributable to seniority and merit.

Schedule of Funding Progress (Unaudited – Required Information) (In Thousands)

Valuation Date	Actuarial Asset Values	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
December 31, 2001	$ 3,790,887	$ 4,866,414	$ 1,075,527	77.8%	$ 2,434,512	44.2%
December 31, 2002	4,100,623	5,542,082	1,441,459	74.0	2,298,839	62.7
December 31, 2003	4,606,439	6,276,942	1,670,503	73.4	2,562,793	65.2

NOTE 9 – LEASES

The Agency entered into an operating lease agreement for rental of certain equipment, which commenced in April 2001. The lease agreement requires monthly rental payments of $29,789 through 2007. Future minimum lease payments are as follows:

2005	$ 357,468
2006	357,468
2007	268,101
Total	$ 983,037

NOTE 10 – LONG-TERM SUPPLY AGREEMENTS

In March 1996, the Agency entered into a long-term power supply contract with Enron Power Marketing, Inc. ("Enron") with a scheduled contract expiration date of December 31, 2008. On December 3, 2001, Enron notified the Agency that effective immediately, it would no longer supply power to the Agency required under the terms of the contract. Under the terms of the contract, the Agency is entitled to a Termination Payment, defined as the present value of the incremental increase in costs incurred to locate an alternative supplier. Accordingly, pursuant to the terms of the contract, the Agency estimated a termination payment totaling $502,602 and recognized such amount as miscellaneous income during the year ended June 30, 2002. During fiscal 2003, Enron disputed this amount, and, as a result, $250,000 was paid to Enron.

On December 12, 2001, the Agency entered into a fixed-price contract for the continuous supply of 30 MWH of power with CMS Energy. This contract was sold to Constellation Power Services on March 27, 2003. The exact rates and terms of the agreement are subject to a confidentiality agreement.

On June 14, 2004, the Agency entered into a fixed-price Master Services Agreement with American Municipal Power–Ohio, Inc. (AMP–Ohio) for power supply and hourly load energy services. The term for this agreement is one year with a one year extension option at which time the Agency may choose to join AMP-Ohio or terminate their relationship.

NOTE 11 – RISK MANAGEMENT

The Agency is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors and omissions, workers compensation, and health care of its employees. These risks are covered through the purchase of commercial insurance, with minimal deductibles. Settled claims have not exceeded the commercial liability in any of the past three years.

NOTE 12 – EXTRAORDINARY ITEM

Several items historically deferred under FAS Statement No. 71 and included in deferred cost/credits were reassessed as unrecoverable from future member billings and have been removed from the deferred cost/credits as outlined by FAS Statement No. 101, *Regulated Enterprises – Accounting for the Discontinuance of Application of FAS Statement No. 71*. As a result, an extraordinary credit of $4,071,735 was reported in fiscal 2003.

The following items were included:

Deferred start up costs		$ 1,075,869
Loss on refunding	$ 15,831,823	
Less: Unamortized portion	(4,290,708)	
Less: Current year amortization	(995,164)	10,545,951
10% debt service not billed		693,343
Other deferred costs		122,867
Net interest not credited to members		(16,564,146)
Unrealized market adjustments		154,174
Loss on sale of investments		1,136,590
Other deferred credits		(1,236,383)
Total		$ (4,071,735)

NOTE 13 – AGGREGATE BOND SERVICE COVERAGE

NET REVENUES:		
Operating Revenues		$ 36,757,645
Less Operating Expenses:		
Operations	$ 21,307,923	
Maintenance	2,556,723	
Admin and General	2,085,715	
Total		(25,950,361)
Plus:		
Interest and Miscellaneous Income		1,513,295
TOTAL NET REVENUES, AS DEFINED:		$ 12,320,579
AGGREGATE BOND SERVICE, AS DEFINED (1):		$ 10,832,302
COVERAGE OF AGGREGATE BOND SERVICE BY NET REVENUES		1.14

NOTE 13 – AGGREGATE BOND SERVICE COVERAGE

(1) AGGREGATE BOND SERVICE, AS DEFINED:

Monthly Bond Service:		Number of Months in Fiscal Year	Total for Fiscal Year
May 2003 thru November 2003	$ 882,458	4	$ 3,529,832
November 2003 thru May 2004	912,599	6	5,475,594
May 2004 thru November 2004	913,438	2	1,826,876
Aggregate Bond Service:			$ 10,832,302

1. Section 6.13 of the Power Supply System Revenue Bond Resolution (the Resolution) dated August 23, 1979, as amended, for each Series of Construction Bonds requires – The Agency will, at all times while any of the bonds are Outstanding, establish, fix, prescribe and collect rates and charges for the sale or use of electric power and energy or related services produced, transmitted, distributed or furnished by the System which, together with other income, are reasonably expected to yield (a) for the forthcoming twelve-month period, Net Revenues equal to at least 1.10 times the Aggregate Bond Service for that period and, (b) at all times, Revenues at least equal to the amounts of all deposits required by the terms of the Resolution to be made into the funds and accounts held under the Resolution and not otherwise provided for. Promptly upon any material change in the circumstances which were contemplated at the time the rates and charges were most recently reviewed, but not less frequently than once in each Fiscal Year, the Agency shall review the rates and charges for electric power and energy and related services and shall promptly revise the rates and charges as necessary to comply with the foregoing requirement so that the rates and charges shall produce moneys sufficient to enable the Agency to comply with all its covenants under the Resolution.

   To comply with the requirements of the above Section of the Resolution, the Michigan South Central Power Agency (the Agency) has prepared the Aggregate Bond Service Coverage Calculation for the twelve months ended June 30, 2004.

2. Definitions of the following terms included in the calculation discussed in Note 1 are as indicated in Article I Section 1.01 Definitions of the Resolution:

   Net Revenues
   Revenues
   Operations and Maintenance Costs
   Aggregate Bond Service
   Bond Service

   All references to Generally Accepted Accounting Principles in the above definitions are generally those currently in existence, except for those that are inconsistent with the Resolution, in which case the terms of the Resolution control.